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Central Banks Consider Digital Currency Pros and Cons in US and Europe

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Takeaways

- The Bank for International Settlements and seven central banks are studying how to launch CBDCs and have flagged key issues that will need to be addressed, including interoperability and confidentiality.
- In the U.S., Federal Reserve leaders have questioned the need for a CBDC, given the sophistication of existing payment systems. Offering retail accounts at the Fed would also fundamentally alter the structure of the U.S. banking industry.
- The Bank of England and the U.K. Treasury have formed a taskforce and plan to consult on the merits of a CBDC.
- In Europe, with more decentralized banking and payment systems, the European Central Bank has shown greater enthusiasm for implementing a CBDC, saying it could drive innovation.

The advent of distributed ledger technology and other innovations has resulted in the widespread adoption and use of privately issued digital currencies such as bitcoin and ether, which allow for rapid payments with minimal transaction costs. This phenomenon has prompted central banks around the world to assess their roles in the digital asset economy — in particular, by examining the pros and cons of offering a central bank digital currency (CBDC) to the public.

CBDCs would be liabilities of the central bank that issued them, and could be either wholesale (*i.e.*, accessed only by financial institutions, similar to existing central bank settlement accounts) or retail (*i.e.*, the digital equivalent of cash, to be used as a digital payment instrument by the general public).

China has already initiated its version of a general purpose CBDC. But, while there is real exuberance and interest in this possibility elsewhere, central banks in most major economies are proceeding cautiously.

International Exploration of CBDCs

One of the most serious international efforts to explore the utility of a CBDC system is being led by the Bank for International Settlements (BIS) and central banks from seven jurisdictions (Bank of Canada, Bank of England, Bank of Japan, European Central Bank (ECB), the Federal Reserve System, Sveriges Riksbank and Swiss National Bank). This effort has already identified important challenges that must be addressed in designing an effective CBDC arrangement, including the need to:

- establish interoperability between a CBDC and other key payment systems and arrangements within a jurisdiction to facilitate the easy flow of funds necessary to achieve accessibility, resilience and diversity in payments;
- protect the privacy or confidentiality of consumer payment data;
- allow sufficient transition time for the existing financial system to adjust; and
- maintain flexibility in design to accommodate evolving user needs over time.

Individual countries could also face unique in-jurisdiction legal and structural challenges.

United States

In the U.S., there is a fundamental question of whether a general-purpose CBDC is needed, given the variety of private electronic payment options available within the existing payment system, including online bill payments through banks and payment methods such as PayPal, Zelle and Venmo. They already offer speed and accessibility and are low cost.

Key Federal Reserve governors have signaled their skepticism. Chair Jerome Powell has observed that the U.S. already has a "safe, effective, dynamic, and efficient … domestic payments system [capable of serving] the needs of households and businesses." Fed Gov. Christopher Waller has said that it remains unclear whether "CBDC would solve any existing problem that is not being addressed more promptly and efficiently by other initiatives."

Moreover, a retail CBDC for which the Fed provided accounts directly to the general public would require legislative changes and alter the central bank's role vis-à-vis private commercial banks and the U.S. economy in profound ways. Under existing law, the Fed provides accounts to private commercial banks, which then offer bank accounts to the general public. That structure, in which private commercial banks are intermediaries between the Fed and the public, dates back to the negotiations that brought the Fed into existence in 1913. Providing accounts directly to the public would upend that negotiated balance and could disintermediate private banks by encouraging deposits to flow from them to the Fed.

These factors weigh heavily against an account-based, retail CBDC in the U.S., whatever benefits it might offer in speed, availability, accessibility and cost, especially considering that competition and other initiatives such as FedNow (the Fed's instant payment system due to launch in 2023) are intended to address these very issues. It is therefore highly unlikely that we will see a retail CBDC in the U.S. in the next few years.

Nonetheless, we expect the Fed to continue to participate in the discussions about CBDCs in the U.S. and internationally so it can maintain leadership and influence in setting standards for their design and related policy questions.

United Kingdom

There has also been substantial interest in the structural and conceptual issues in a central bank adopting a CBDC in the U.K. and Europe, with central banks themselves and other market participants debating the benefits, challenges and legal and regulatory requirements.

In November 2021, the Bank of England and U.K. Treasury announced plans for a joint consultation on the subject during 2022. They envision a CBDC being introduced in the U.K. by the end of the decade if there is support from market participants. The two bodies have formed a taskforce to oversee the consultation and any future consideration of such a proposal.

However, several issues in terms of design, control, access, legal framework and regulation remain before any such initiative can be implemented. Like the Fed in the U.S., the Bank of England does not provide accounts directly to the general public. Adopting a "retail" CBDC that requires this therefore would result in a seismic change to the U.K. banking system.

The U.K. Treasury has already stated that it envisions any CBDC as a parallel offering to existing cash and bank deposits, not a replacement. The outcome of the consultation will determine whether the U.K. moves toward a "development" phase.

Euro Zone

In contrast to regulators in the U.S., the ECB has been fairly public in its support for the development of a CBDC in the medium to long term.

In a report published in October 2020, the ECB advocated the introduction of a digital euro, which it argued is needed to underpin innovation, deliver strategic autonomy and guarantee security of European payment systems. Fabio Panetta, a member of the executive board of the ECB, argued in a blog post in November 2021 that the ECB needs to actively consider the role of a CBDC given the move to digital payments over cash. He drew the analogy of the postage stamp falling by the wayside in the age of the internet.

That transition to digital payments is driving much of the thinking on the development of CBDCs in Europe and the U.K. Mr. Panetta also argued that central institutional involvement in money, whether through a CBDC or otherwise, will remain a cornerstone underpinning confidence in the value of money and the financial system, and that development work and debate is needed now to address the structural and regulatory challenges of a CBDC.

The ECB project focuses on a "retail" CBDC in particular, which would mark a significant shift in the current payment ecosystem if adopted. To the extent the ECB has addressed wholesale systems, it has concentrated on technical upgrades to existing systems rather than the introduction of a CBDC.

We anticipate that central banks in the U.K. and Europe will continue exploring CBDC models, with increased focus in the next few years. Much of this work will be preparatory and technical rather than moving swiftly to adoption. But central banks in the region appear much more open to introducing CBDCs later this decade than their counterparts around the world.